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September 16, 2003

VIA ELECTRONIC FILING

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S. W. – Room TWB-204
Washington, D. C. 20554

Re: *Ex parte,* CC Docket No. 96-149, Verizon Petition for Forbearance from the Prohibition of sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules

Dear Ms. Dortch:

On Monday, September 15, 2003, Aryeh Friedman and the undersigned of AT&T and Dr. Lee Selwyn and Hilary Thompson, of Economics and Technology, Inc., met by telephone with Pamela Megna and Christi Shewman of the Wireline Competition Bureau's Competition Policy Division. The purpose of the meeting was to discuss Dr. Selwyn's written submissions in the above-captioned proceeding and Verizon's August 11, 2003 response to those arguments. The attached document provides a summary of the topics discussed and was distributed via electronic mail to the Commission staff on the call.

Consistent with Section 1.1206 of the Commission's rules, I am filing one electronic copy of this notice and request that you place it in the record of the above-captioned proceeding.

Sincerely,

F S Simone

ATTACHMENT

cc: W. Dever
P. Megna
C. Shewman
R. Tanner

Verizon has not demonstrated that OI&M integration will result in any net savings in resources used.

- In fact, Verizon's characterization of the FCC's affiliate transaction rules as being "based on fully distributed cost principles" underscores the concern about how GNI intends to "pay" the Verizon BOCs for OI&M services that the BOC would provide if Verizon's forbearance petition is granted.

- Section 272 Affiliate transactions are supposed to be based upon "arm's length" principles requiring that the BOC ILEC realize the full market value of the service provided, not merely that it be reimbursed for its costs. Verizon and the other BOCs have flaunted this requirement by exploiting the "prevailing company price" loophole for virtually all affiliate transactions, ensuring that the BOC never receives full and fair market value for the services it provides.

- Verizon's use of the "prevailing company price" loophole is premised upon its representation that all services being furnished to a Sec. 272 affiliate will be offered and available on a nondiscriminatory basis to nonaffiliated firms.

- Verizon's claims that it will provide OI&M services to unaffiliated entities on a nondiscriminatory basis are disingenuous considering that Verizon regularly structures its affiliate transactions such that, as a practical matter, only the Verizon affiliate is capable of using the service or qualifying for the lowest price. For example, its Section 272(b) posting regarding billing and collection offers large discounts to "any" purchaser of these services that provides 85% of its *total* Verizon end user billing to Verizon for processing.[1] The only entity that would typically qualify for this discount is, of course, Verizon Long Distance.

- Verizon asserts that it "would file Cost Allocation Manual ('CAM') changes" using time reporting codes "to be created and defined" (*see*, Verizon June 24, 2003 *ex parte* at 4) and "new non-regulated cost pools as *necessary*" that should allay any fear that it "would violate the Commission's Part 64 cost allocation rules by failing to allocate BOC OI&M expenses to the section 272 affiliates at fully distributed cost. Verizon August 11, 2003 *ex parte* at 3. But the possibility of undefined costs and possible new cost pools would not help to detect or deter any cost misallocation by Verizon. ARMIS reports simply report a regulated/non-regulated split, and do not lend themselves to tracing back specific expenses. Moreover later, after-the-fact audits are insufficient to deter current misallocation.

[1] *See*, http://www.verizonld.com/PDFs/am06bsarates08-04-03.pdf.

Verizon is unclear as to whether the GNI OSS functions will be provided by BOC personnel using GNI OSS, or through modifications to the BOC's OSS.

- Verizon appears to have told the FCC staff that BOC personnel will continue to utilize GNI's OSS.
- However, in the June 4 *ex parte* Attachment 3 at 5, note 4, Verizon states that if the Petition is granted GNI will then avoid the cost of purchasing software and hardware updates for its OSS. But if GNI ceases purchasing software and hardware updates for GNI's OSS, that implies that GNI intends to *abandon* its OSS and rely instead solely upon the BOC's systems.
- After years of claiming that it was impractical for Verizon to grant others access to the BOC's OSS, Verizon apparently now intends to give GNI access to its BOC OSS if it is no longer subject to OI&M separation. This would then require that the Verizon BOCs afford direct access to their OSS to nonaffiliated CLECs and IXCs, something that they have long insisted cannot be done — and which they have not explained how it will be done if the forbearance petition is granted.

Verizon has always been free to contract with any number of unaffiliated entities for many of the OI&M services that it now seeks to "purchase" from the BOC.

- For example, Verizon could have contracted with any number of other "call center" service providers for back office operator services, and thereby avoided the cost of building the Altoona and Worcester operator service facilities that it claims was made necessary specifically because of the OI&M separation requirement.
- However, such a contract would have been a true arm's length transaction, and would therefore almost certainly represent an out of pocket cost to Verizon higher than the fully distributed cost Verizon intends to charge itself.
- Hence, the "savings" that Verizon now claims will result from OI&M integration is, in reality, primarily if not solely attributable to the fact that its "prevailing company price" transfer price will be well below the fair market value of the services that the BOC will be providing to the Sec. 272 affiliates.

Verizon's intentions regarding the expansion or overextension of the BOC workforce are not clear.

- Verizon's newest claim is that it does not assume an "absorption without incurring additional cost" of GNI work by BOC employees. However, this assertion is belied by statements such as, "[t]his over-dependence on vendor-supplied labor would not have been necessary if Verizon could have used BOC personnel, which had both the necessary skill sets as well as the ubiquitous presence to perform OI&M services for GNI on an as-needed basis" (Howard Supplemental Declaration, at 3).

- Importantly, it was *Verizon*, not AT&T, that had first raised the notion of "absorption" of the GNI requirements within BOC workforces:

  June 24 ex parte at 7:

  "Professional Services – ... Furthermore, there are enough local exchange carrier technician in geographic areas where GNI built its Hubs and POPs *that the work could be absorbed by the existing staff of local exchange carrier technicians* (GNI employees 34 technicians compared to thousands employed by the local exchange carrier)." Emphasis supplied.

  "Back Office – ... the existing local exchange carrier 611 centers (Customer Repair Service Answering Bureau, or CRSAB) can do the same thing *and they are sufficiently large to absorb the incremental work*. The existing local exchange carrier Recent Change Administration Center, or RCMAC, is likewise able *and sufficiently large to absorb* the incremental manual provisioning of long distance orders." Emphasis supplied.

Verizon's claim that the existence of price cap regulation removes its incentives to cross-subsidize its Sec. 272 affiliates is patently false.

- *CALLS* is not "pure price caps" as Verizon claims. However, even if it were, Verizon would still have a powerful incentive to shift costs *out* of its long distance affiliates so as to enhance their ability to compete with nonintegrated rivals.

- *CALLS* is set to expire — and to be reviewed and perhaps replaced — in 2005. Indeed, when the *CALLS* plan was adopted by the FCC, the Commission specifically expressed the *expectation* that by 2005:

  "..increased competition will serve to constrain access rates in the later years of the CALLS Proposal as X-factor reductions are phased out. We believe that market forces, instead of regulatory prescription, should be used to constrain prices whenever possible. As competitors utilizing a range of technologies, including cable, cellular, MMDS and LMDS, continue to enter the local exchange market, we expect that rates will continue to decrease... Therefore, the significant up-front reductions coupled with increased competition ultimately should result in access charges that are comparable to those that would be achieved under out current price cap system over the five-year term of the CALLS Proposal. Furthermore, after the five year term we can re-examine the issue to determine whether competition has emerged to constrain rates effectively."[2]

That, of course, has not happened, and is unlikely to happen by 2005.

- Although Verizon would like to relegate to mere "speculation" the issue of Commission review of price caps and of *CALLS*, with the expiration of *CALLS* and an access market that is still far from being competitive, the Commission will necessarily have to consider the future of access charges and of price cap regulation generally. If Verizon is able to load costs onto its ILECs, those costs (if not detected and eliminated) could then be used to support a higher overall ILEC access charge rate level and a less onerous (from Verizon's perspective) price adjustment mechanism under a reexamination of CALLS and possible reinitialization of access charges at the 11.25% ILEC authorized rate of return.

[2] *Access Charge Reform*, CC Docket No. 96-262, *Sixth Report and Order*, CC Docket Nos. 96-262 and 94-1, *Report and Order*, CC Docket No. 99-249, *Eleventh Report and Order*, CC Docket No. 96-45, 15 FCC Rcd 12962, 13031 (2000).